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## Viewing cable 08MEXICO2184, U/S JEFFERY'S VISIT TO MEXICO: THANK YOU FOR

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Reference ID	Created	Released	Classification	Origin
<a href="#">08MEXICO2184</a>	<a href="#">2008-07-16 16:45</a>	<a href="#">2011-08-30 01:44</a>	<a href="#">CONFIDENTIAL</a>	<a href="#">Embassy Mexico</a>

Appears in these articles:

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C O N F I D E N T I A L SECTION 01 OF 04 MEXICO 002184

SIPDIS

STATE FOR E UNDER SECRETARY JEFFERY  
STATE FOR WHA/FO FOR TOM SHANNON  
STATE FOR WHA/MEX FOR LIZ WOLFSON  
STATE FOR WHA/EPSC  
STATE FOR EB/ESC MCMANUS AND IZZO  
USDOC FOR 4320/ITA/MAC/WH/ONAFITA/GWORD  
USDOC FOR ITS/TD/ENERGY DIVISION  
TREASURY FOR IA (RACHEL JARPE AND LUYEN TRAN)  
DOE FOR INTL AFFAIRS ALOCKWOOD, AND GWARD

STATE PASS USTR FOR EISSENSTAT/MELLE/SHIGETOMI  
STATE PASS FEDERAL RESERVE (ANDREA RAFFO)  
NSC FOR RICHARD MILES, DAN FISK

E.O. 12958: DECL: 07/15/2018

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SUBJECT: U/S JEFFERY'S VISIT TO MEXICO: THANK YOU FOR  
SILENCE ON ENERGY DEBATE; BIOFUEL QUESTIONS

Classified By: A/DCM ISIAH PARNELL FOR REASONS 1.4(b) and (d)

¶1. (SBU) SUMMARY: U/S Jeffery visited Mexico City on July 10-11 where he met with officials from the Mexican Secretariats of Finance (Hacienda), Agriculture (SAGARPA), and Energy (SENER), as well as the head of Petroleos Mexicanos (PEMEX), the state oil company. Energy and biofuels were the key topics during the visit. Mexican interlocutors expressed their gratitude that the USG has refrained from commenting on Mexico's energy reform proposal.

They were also candid in their evaluation of Pemex's challenges and oil production. They conveyed their displeasure with current USG biofuel policy and the diverting of corn for energy while food prices are so high, though conceded that the high prices encourage rural investment. U/S Jeffery also had an opportunity to meet with business leaders, Bank of Mexico officials, and analysts to discuss the current global economic situation and the effect on the Mexican economy. END SUMMARY

Mexicans: Thank You For Not Commenting on Energy Reform  
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¶2. (C) Jesus Reyes Heróles, Director General for Pemex, was one of several officials to express his gratitude that the USG has kept out of the current energy debate. He explained that energy discussions are extremely political given historic sensitivities and the "sovereignty chip" that many Mexicans have regarding oil and Pemex. He said that the lack of public comments from both the USG and the Mexican private sector have made it easier to negotiate with the opposition. SENER U/S for Energy Planning and Technological Development, Jordy Herrera, commented that "the best way to help in energy reform is to leave (Mexican) Congressmen alone". Herrera said that the PRI party will be having their national assembly on August 23rd, which will give the Calderon Administration a better idea of whether/how its energy reform proposal will prosper. Herrera remained optimistic that the reform would ultimately pass, though uncertain of its final form.

Pemex, Energy Reform, and Oil Production  
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¶3. (C) Reyes Heróles said that Pemex officials see the ongoing debate on energy reform as positive, since it makes the public more aware of Pemex's vulnerable situation. He said that he would be satisfied with the modest reform that changes corporate governance (through the addition of independent members to the board of directors) and grants the freedom to budget and contract debt without having to jump through the bureaucratic hoops mandated by the current Public Works Law and without Hacienda's approval. In addition to the reform, he said that he is also making an effort to change the company's image as well as train and improve its human capital. He noted that the previous administration did not leave any projects in the works, and due to lack of pipelines, gasoline is being moved increasingly by costly and inefficient trucks. He noted that no new refineries have been built in 16 years and expressed his frustration at the slow pace of Pemex development and likened it to "watching good opportunities pass by". He said that with such second-rate performance it is very difficult for Pemex to compete in the global market.

¶4. (C) With regard to oil production, Reyes Heróles explained that technical problems and terrorist attacks have had a negative impact on production in the past year. He said that although the problems have been resolved, it is unlikely that Pemex will achieve its goal of 3 million barrels per day

(bpd) for 2008. He stressed, however, that the goal will remain 3 million bpd to encourage increased production for the remainder of the year. SENER's Herrera also commented on oil production, saying it will likely reach only 2.7 million bpd because Cantarell is declining faster than expected and new sources have not been found as quickly. He said that Cantarell production is expected to decline by 50% in the next 4-5 years and then stabilize.

15. (C) Herrera also commented on the issue of Mexican subsidies. He admitted that they were untenable because the high cost of shipping fuel around the country is making it hard for the GOM to meet demand at current prices and consumption levels. Despite this, he felt that in the short term the GOM will not eliminate the subsidies due to inflationary concerns.

16. (C) Both Reyes Heróles and Herrera admitted that pipeline security is a problem. Reyes Heróles said that it would take approximately 3 years to have a system that is less vulnerable to attacks whereas Herrera said "There is no way we can protect facilities. We don't have the money or the capabilities." Herrera explained that the GOM is not accustomed to attacks like those of last summer and while the Interior Ministry had a plan, it involved the use of military assets and would have been too expensive. Also, the lack of coordination between federal, state, and local authorities compounds the problem. He said that they are developing technology that by next year will hopefully provide assistance and that Mexicans have been working with DHS and DOE on critical infrastructure protection. They are waiting until the end of the energy reform debate to move on to the next stage of cooperation involving a visit by Mexican Energy Secretary Georgina Kessel to the U.S. to discuss technology sharing.

#### Biofuels a Hot Topic

17. (C) Biofuels, specifically USG support for production of corn-based ethanol, was raised at every meeting attended by U/S Jeffery. SAGAPRA U/S for Agriculture, Francisco Lopez Tostado, expressed his concern that current U.S. biofuel policy will contribute to a further rise in food prices through its effect on supply. He also worried that Mexico's supply of grain, which relies heavily on imports from the U.S., is being determined in part by a policy that the GOM has no ability to influence. Reyes Heróles questioned the environmental benefits of ethanol. He referenced studies that showed that ethanol did not provide as much of an environmental gain as previously thought.

18. (C) The officials also noted that Mexico has its own biofuels law, passed in October 2007. Tostado noted that the law restricts corn-based ethanol production. He said that Mexico is looking into sugar-based or 2nd and 3rd generation production methods. He added that Mexico's biofuel system is geared toward managing surpluses, not competing with market demand. Hacienda Secretary Agustín Carstens noted the challenges associated with biofuel development in Mexico caused by the lack of agricultural productivity and the politicization of agriculture policy. SENER's Herrera explained that Mexico is looking for biofuels that will not use corn or imports and that sugar is problematic because prices are set by law. He said that they are looking into using algae or jatropha for biofuels, including diesel. They will start with a target of 2% ethanol content in gasoline in the major metropolitan markets of Guadalajara, Monterrey, and Mexico City by 2010 and then evaluate their progress. Herrera noted that Mexico will host the 2nd annual international conference on biofuels next year.

#### High Food Prices Can Be Positive

19. (C) In meetings with both Hacienda and SAGARPA, Carstens and Lopez Tostado noted that, while high food prices pose a problem, they also provide a production incentive and

encourage greater investment in rural agriculture, something that has been missing in Mexico. Tostado said that the GOM is trying to take advantage of current prices for the benefit of the producer, while at the same time providing some protection to the consumer. He said that Mexico is expanding production but is not currently able to meet its own demand. He feels that technology will be important in increasing production and solving the current food price problems. He discussed a proposal by regional Agriculture Ministers that would call for technology sharing via the FAO.

#### BOM Officials, Analyst Discuss Mexican Economic Outlook

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¶10. (C) U/S Jeffery met with officials from the Bank of Mexico (BOM), including Deputy Governor Guillermo Guemez. Guemez said that Mexico's economic outlook is similar to the rest of the world except that the rise in food prices affects Mexico more acutely due to high poverty levels here. He further said that, while inflation is currently around 5%, it would be closer to 8% but for the subsidies on gas and diesel. Guemez noted that recent exchange rate fluctuations have benefited Mexico in U.S. markets because Mexican goods generally compete with imported goods from countries whose currencies have appreciated more quickly versus the dollar. He also commented that while growth in remittances has declined, the decline is false in that the recent increases were due to better data capturing. Guemez said that Mexico has a good opportunity now that high oil prices are cutting into China's competitive edge, but Mexico could miss the opportunity unless it deals with issues such as infrastructure and border wait times.

¶10. (C) Analysts echoed the sentiments of BOM officials and provided a lively discussion on the prospects of energy reform, inflation and growth, and the overall success of the Calderon Administration thus far. They felt that the energy reform proposal, like other Calderon economic initiatives, was weak. Rogelio Ramirez de la O, a former economic advisor to failed leftist presidential candidate Andres Manuel Lopez Obrador, felt that parts of the reform, specifically the additional independent advisor, would make Pemex less, not more, effective. The analysts agreed that Calderon did not fully utilize his political capital and his plurality in the Senate to pass stronger reforms and thereby wasted an important opportunity to improve competitiveness during his presidency. The analysts believed that the BOM will raise interest rates in the near future to counter inflation, though Sergio Luna Martinez, an economist at Banamex, predicted that the BOM will wait another month before doing so. The analysts agreed with Rogelio Ramirez's assertion that the economic situation is currently very volatile and it will be difficult for the next 12-18 months.

#### AmCham Raises Energy and Competitiveness Issues

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¶11. (SBU) Members of the AmCham stated that their main issue is energy costs. They also asked about alternative energy sources and USG plans to cope with high oil prices. Competitiveness was an important topic for the group, and the U/S, along with Embassy officials present, spoke about the current steps being taken to facilitate border trade in light of the need for heightened security at the border.

#### Comment

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12 (C) U/S Jeffery's visit touched on two politically sensitive issues in Mexico, energy and corn. As repeatedly noted by the top Mexican officials during the visit, the biggest contribution the USG can make to the Calderon government's energy reform proposal is to stay out of the picture for the next few months as the congressional debates and mark-ups move toward a possible final vote. Seven decades after the big foreign companies were kicked out and the oil industry nationalized, this subject still evokes a

highly emotional nationalistic response across a large swath of the Mexican public and polity. We cannot over-emphasize the probable negative reaction of any USG interventions - no matter how well-reasoned or intentioned - on this subject during this period. Officials also clearly expressed their worry over USG subsidies for corn-based ethanol and the effect on corn exports to Mexico. Somewhat surprisingly, the salmonella threat did not come up in meetings except when Tostado commented that our bilateral relationship is strong enough to overcome such health issues.

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